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No. 06-451

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SUPREME COURT, U.S.

In The

Supreme Court of the United States

JIMMY V. DUNN, *et al.*,

Petitioners,

v.

NETCO, INC., *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The Supreme Court Of Missouri

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Does a non-signatory "clearly and unmistakably" agree to let an arbitrator, rather than the court, determine the existence, scope and validity of a purported arbitration agreement even though that person never signed a writing containing an arbitration clause and thus never expressly agreed to any arbitration rules incorporated therein by reference, including an "arbitrator may decide arbitrability" clause?

The identical question is before the Court in a petition for a writ of certiorari in the companion case of *Dunn v. Nitro Distributing, Inc.*, Case No. 06-446.

CORPORATE DISCLOSURE STATEMENT

Respondents Netco, Inc., and Schmitz & Associates, Inc., have no parent companies and no subsidiaries. No publicly held company owns 10 percent or more of either Respondent.

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RESPONDENTS' BRIEF IN OPPOSITION

The Petition should be denied. The issue raised in petitioner's Question Presented was never addressed by the Missouri Supreme Court or by any lower court. Thus, this case presents no direct conflict and no live issue for the Court's consideration. Nor have petitioners managed to show any significant conflict among other courts on the issue they raise.

The Question Presented, as framed by petitioners, is whether parties have "clearly and unmistakably" agreed to have the issue of arbitrability decided by an arbitrator, rather than a court, when an "arbitrator may decide arbitrability" clause is merely incorporated by reference in, rather than expressly set forth on the face of, an arbitration agreement. But none of the courts below expressed an opinion on that issue one way or the other. Nor did they even need to reach that question here. In fact, even if the arbitrability clause had been plainly stated on the face of the purported arbitration agreement, the result here would be no different. The Missouri Supreme Court could not reach the question of whether the parties agreed to arbitrate arbitrability unless and until it first determined the substantive "gateway" issue of whether the non-signatories agreed to the arbitration provision itself. If, as here, the non-signatories[1] never agreed to arbitrate in the first instance, they obviously never agreed to any arbitration rules incorporated by

[1] The Missouri Supreme Court did find that one of the plaintiffs here agreed to arbitrate under one of the arbitration agreements at issue. But, in that instance, it found an agreement by estoppel, not because the plaintiff was a signatory.

reference, such as a rule authorizing an arbitrator to decide arbitrability.

Even if the Missouri Supreme Court had addressed petitioners' Question Presented, it is premature to declare that there is a true conflict among the courts on this issue. Petitioners cite to only one case – a South Dakota state court decision – that expressly held that incorporation of an arbitrability clause by reference is insufficient to constitute clear and unmistakable evidence of an agreement to arbitrate arbitrability. South Dakota stands alone against the First, Second, Eighth and Eleventh Circuits, and the Delaware Supreme Court, all of which have held to the contrary. A single aberrant decision from a state court does not create the type of intolerable conflict that justifies this Court's intervention.

For these reasons, petitioners have not demonstrated compelling reasons for granting certiorari, and their Petition should be denied.

STATEMENT OF THE CASE

Petitioners' rather simplistic Statement of the Case belies this dispute's complexities. This arbitrability dispute arose from a lawsuit filed by plaintiffs-respondents Netco, Inc. ("Netco"), and Schmitz & Associates, Inc. ("Schmitz Associates"), against eleven individuals and corporations, nine of whom are petitioners here. (Pet. at ii). Netco and Schmitz Associates are, or at least until the events giving rise to their suit were, engaged in the sale of Amway-related "BSMs" (business support materials). BSMs are motivational products (*e.g.*, audiotapes, videotapes and literature, also known as "tools") and services

(seminars, rallies, and conventions, referred to as "functions") used to motivate and train Amway distributors. In their lawsuit, plaintiffs Netco and Schmitz Associates alleged, in essence, that the petitioners, all of whom are competitors of plaintiffs in the Amway-related BSMs business, conspired to deprive Netco and Schmitz Associates of their businesses.

At issue in this case are two purported arbitration agreements: (1) the Amway Arbitration Agreement, and (2) the Pro Net Arbitration Agreement. As explained in more detail below, it was undisputed that Schmitz Associates was not a signatory to either agreement. Applying ordinary state contract law principles, the Missouri Supreme Court held that Schmitz Associates was not bound to arbitrate under any of the assorted legal theories advanced by petitioners, such as third-party beneficiary, estoppel, agency and an alter ego-like theory. Given its finding that Schmitz Associates never agreed to arbitrate in the first place, the Missouri Supreme Court had no occasion to reach the question of what that non-existent agreement may have provided, including whether Schmitz Associates agreed to let an arbitrator decide arbitrability, or whether it did so clearly and unmistakably. Nor was this non-issue reached by either of the lower courts.

With respect to the Pro Net Arbitration Agreement, the Missouri Supreme Court found that Netco was estopped to deny arbitration. Having found an agreement to arbitrate by estoppel, it compelled Netco to arbitrate its claims with the signatory petitioners. Because Netco was, in fact, compelled to arbitrate with the signatory petitioners, petitioners' Question is to this extent moot.

With respect to the Amway Arbitration Agreement, the Missouri Supreme Court found that Netco was a signatory to the Amway "distributorship agreement," but did not compel Netco to arbitrate because BSMs disputes are not within the scope of the Amway Arbitration Provision. Netco signed its distributorship agreement in 1991 – seven years *before* Amway ever adopted an arbitration provision. Thus, even though Netco was a signatory to the "*distributorship* agreement," it was not an actual signatory to any express "*arbitration* agreement." Under these facts, even if it could be said that the Court should have reached the arbitrability question, no court could possibly find that Netco clearly and unmistakably agreed to arbitrate arbitrability, when an arbitration provision did not even exist when Netco signed its Amway distributorship agreement. And, because Netco was, in any event, compelled to arbitrate under the Pro Net agreement, whether it may also be bound to arbitrate under the Amway agreement is purely academic.

I. The Amway Arbitration Agreement

Plaintiff Netco is a corporation owned by non-parties Charlie and Kim Schmitz. The Schmitzes operated both their Amway distributorship business and their "tools" business under Netco. In this action, however, they only seek damages relating Netco's BSMs business.

In their quest in the courts below to show that Netco agreed to arbitrate under the Amway Arbitration Agreement, petitioners relied on three separate writings dating

from 1984 to 1991.[2] Only one of those documents, however, was signed by Netco – a 1991 application to become an Amway distributor. The other two were signed by Charlie Schmitz, individually. In fact, the only writing upon which petitioners now rely in support of their petition for a writ of certiorari is the 1984 application of Charlie Schmitz, *individually*, to become an Amway distributor as a sole proprietor. (Pet. App. at 74a-75a). In 1990, the Schmitzes incorporated Netco and began operating their Amway distributorship as a corporation.

When Netco signed its application to become a corporate Amway distributorship in 1991, it agreed to abide by Amway's Rules of Conduct then in effect. In 1991, those Rules did not include an arbitration provision. Unbeknownst to Netco and many other distributors, Amway *unilaterally* amended its Rules of Conduct in 1998 to require mandatory arbitration of certain disputes. Those arbitration rules provided for arbitration before JAMS/ Endispute, Inc. (*id.* at 77a), and also included a rule stating that "disputes over the existence, validity, interpretation or scope of the agreement . . . *may* be submitted to and ruled on by the Arbitrator, *unless the relevant law requires that a court make such determination.*" (*Id.* at 76a (emphasis added)). Netco's distributorship was

[2] Aside from these writings, Petitioners also argued in the courts below that plaintiffs were bound to arbitrate (1) under an implied contract theory based on Netco's renewal of its Amway distributorship, and (2) that plaintiffs agreed to arbitrate under Amway's Rules of Conduct when they became Pro Net members. Neither theory was addressed by the Missouri Supreme Court.

automatically renewed[3] once after the 1998 adoption of arbitration, and a few months later in 1999, Netco sold its Amway business. Netco never signed any writing agreeing to Amway's rules as amended.

Netco denied making an arbitration agreement on a number of grounds, among them that it had no notice of the adoption of any arbitration provision and therefore there was no meeting of the minds, and that the arbitration provision itself was illusory[4] and unconscionable.[5] Netco also asserted that its BSMs disputes were not within the scope of the Amway arbitration provision.

Petitioners also sought to compel Plaintiff Schmitz Associates to arbitrate under the Amway Arbitration Agreement, notwithstanding the fact that it was not an Amway distributor and did not sign any Amway distributorship agreement or arbitration provision. In an effort to avoid this generally fatal problem, petitioners attempted to bind Schmitz Associates to the supposed arbitration agreements of Netco and Charlie Schmitz under various legal theories, including third-party beneficiary, estoppel, agency and an "alter ego-like" theory. Schmitz Associates challenged each of those theories, and joined in Netco's

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[3] Amway requires its distributors to renew their distributorships annually. Netco's distributorship was annually renewed "automatically" without signing any papers.

[4] Amway reserved the right to unilaterally amend its rules at any time.

[5] Among many other things, Amway hand-picked and then trained these select arbitrators on the very substantive legal issues they would be asked to decide in arbitration. These were the only arbitrators eligible to hear disputes under the Amway Arbitration Agreement.

arguments that Amway arbitration is illusory and unconscionable and that BSMs disputes are not within its scope.

In a letter ruling, the trial court stated that the Amway Arbitration Provision was unconscionable, and therefore denied petitioners' motion to compel arbitration. (Pet. App. 33a-35a) After petitioners moved for rehearing, the trial court issued its judgment denying arbitration without explaining its decision. (*Id.* at 36a). The appellate court did not reach the Amway Arbitration Provision because it found that both Netco and Schmitz Associates were bound to arbitrate under the Pro Net Arbitration Agreement – a finding later reversed as to Schmitz Associates.

On review, the Missouri Supreme Court affirmed in part and reversed in part the trial court's denial of petitioners' motion to compel arbitration. Sidestepping the issue of whether the Amway Arbitration Provision was unconscionable as the trial court had found, the Missouri Supreme Court ruled with regard to Netco that although "it is a signatory to an Amway distributorship agreement," (*id.* at 7a), Netco was not bound to arbitrate because its claims were not within the scope of the Amway Arbitration Agreement. (*Id.*) With respect to Schmitz Associates, the Missouri Supreme Court found, applying ordinary state contract principles, that it was not bound to arbitrate under any of petitioners' asserted legal theories. (*Id.* at 4a-6a).

Importantly, neither the Missouri Supreme Court nor either of the lower courts ever even mentioned the arbitrability clause, let alone that clear and unmistakable evidence of an agreement to let an arbitrator decide

Question Presented. As is plainly evident from the face of the opinions and judgment of the courts below, not one stated that it was refusing to give effect to an arbitrability clause because it was incorporated by reference rather than expressly printed on the face of the arbitration agreement.[6] Simply stated, it was a non-issue in this case.

A. The Result Below Would Be The Same Even If An Arbitrability Clause Were Expressly Stated In The Purported Arbitration Agreement

Petitioners' real complaint has absolutely nothing whatsoever to do with whether "incorporation by reference" satisfies *First Options'* "clear and unmistakable" evidence standard. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995). Indeed, the result in this case would be exactly the same even if the arbitrability clause had been plainly stated in large, bold print on the face of the purported arbitration agreements. Unless and until a court first determines that a non-signatory agreed to arbitrate *something,* it logically cannot reach the question of whether that non-signatory also agreed to arbitrate arbitrability. Were it otherwise, a party could merely wave an unsigned piece of paper containing an arbitration provision and arbitrability clause, proclaim to the court that some person agreed to it and, despite the

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[6] Nor can it reasonably be inferred from the court's silence on the issue that the reason it did not perfunctorily ship this case off to arbitration as petitioners had urged was that the arbitrability clause was only incorporated by reference. As shown below, notwithstanding the existence of an arbitrability clause, the Missouri Supreme Court had a duty to first determine whether the non-signatories made an arbitration agreement before it could compel arbitration of *any* issue.

notable absence of his signature, compel that non-signatory to arbitrate something he never agreed to arbitrate. That is precisely what petitioners are attempting to do here. But this Court has re-affirmed time and again that the issue of whether a non-signatory is bound by an arbitration agreement it did not sign is an issue for the court, not an arbitrator, to decide. *See, e.g., First Options,* 514 U.S. at 944; *Howsam v. Dean Witter Reynolds, Inc.,* 537 U.S. 79, 84 (2002). Requiring a person to arbitrate *anything* – be it the merits or arbitrability – based on a supposed agreement that person never signed, without first finding that he is otherwise bound under ordinary contract principles, violates the first principle of arbitration: a person cannot be compelled to arbitrate something he did not agree to arbitrate. *See AT&T Tech., Inc. v. Communications Workers of America,* 475 U.S. 643, 648 (1986).

Petitioners' real contention – although not asserted in their Question Presented – is that the arbitrability clauses here completely divested the Missouri Supreme Court (and lower courts) of any jurisdiction whatsoever to determine the "existence" of an arbitration agreement – even as to non-signatories who never signed *any* writing containing an arbitration clause. Petitioners' real complaint is thus nothing more than that the Missouri Supreme Court erred in deciding the "existence" of an arbitration agreement, instead of referring that question to an arbitrator.

Although the Missouri Supreme Court did decide the "scope" of the Amway arbitration provision after finding that Netco had made an agreement to arbitrate, such was not error. It is undisputed that Amway's arbitration rules, including the arbitrability clause, were not even in existence when Netco signed its distributorship application in 1991. Amway's arbitration provision was not adopted until

1998. Netco never signed any writing after 1991 incorporating Amway's amended Rules of Conduct, and, indeed, was unaware of the existence of the unilaterally imposed arbitration provision until this litigation commenced.[7] *First Options'* "clear and unmistakable" standard cannot possibly be met under these circumstances. Thus, the Missouri Supreme Court did not err in deciding the scope of the Amway Arbitration Agreement.

In any event, petitioners' complaint that the Missouri Supreme Court decided the scope of Amway arbitration is a moot point here. The Missouri Supreme Court compelled Netco to arbitrate its claims with the other signatories to the Pro Net Agreement before the AAA. Therefore, whether Netco is also bound to arbitrate under the Amway Arbitration Provision before JAMS is a purely academic question. Obviously, Netco cannot be required to arbitrate the same claims against the same petitioners[8] in two different forums.

Even if the Missouri Supreme Court had erred in deciding the scope of the Amway Arbitration Agreement – which it did not – one court's purported error does not make a certworthy case. Recognizing this, petitioners try

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[7] Presumably, the Missouri Supreme Court found that Netco assented to Amway's arbitration provision not expressly, but rather impliedly, by the one-time renewal of its distributorship after Amway had amended its rules to require arbitration.

[8] The only petitioners who could possibly be entitled to arbitrate with Netco under the Amway agreement are Gooch, Childers and Dunn, individually – the same persons against whom Netco already must arbitrate under the Pro Net agreement. The remaining petitioners – Pro Net, Global, Gooch Support, Gooch Enterprises, TNT and Dunn Associates – are not Amway distributorships and thus not entitled to enforce the Amway Arbitration Provision.

to fit this case into a perceived conflict among *other* courts as to whether an arbitrability clause that is merely incorporated by reference provides clear and unmistakable evidence of an agreement to arbitrate arbitrability. But this case does not fit. There is a decisive difference between this case and the cases cited by petitioners that squarely present the perceived conflict. In all of the cases cited by petitioners, the party trying to avoid arbitration was a *signatory* who plainly agreed to arbitrate and who thus agreed to the terms incorporated by reference, including arbitrability clauses. *See Flandreau Pub. Sch. Dist. #50-3 v. G.A. Johnson Constr., Inc.*, 701 N.W.2d 430, 434 (S.D. 2005); *Apollo Computer v. Berg,* 886 F.2d 469, 470 (1st Cir. 1989); *Contec Corp. v. Remote Solution Co.,* 398 F.3d 205, 207 (2d Cir. 2005); *FSC Sec. Corp. v. Freel,* 14 F.3d 1310, 1311 (8th Cir. 1994); *Terminix Int'l Co. v. Palmer Ranch Ltd. P'ship,* 432 F.3d 1327, 1328 (11th Cir. 2005); *James & Jackson, LLC v. Willie Gary, LLC,* 906 A.2d 76 (Del. 2006).[9] In contrast, in this case, the Missouri Supreme Court was presented with *non-signatories* who never signed any writing containing an arbitration clause,[10] and therefore never expressly agreed to any

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[9] Contrary to petitioners suggestion, the Federal Circuit in *Microchip* did not express an opinion one way or the other on whether incorporation by reference satisfies *First Options*' clear and unmistakable evidence standard. *See Microchip Technology, Inc. v. Phillips Corp.*, 367 F.3d 1350, 1354 (Fed. Cir. 2004). Therefore, it does not squarely present the issue as to which petitioners perceive a conflict.

[10] Although the Supreme Court found that Netco was a signatory to the Amway *distributorship* agreement, it was not a signatory to the then non-existent *arbitration* provision. (Pet. at 7a). And the Court did not find that Netco was a signatory to the Pro Net Arbitration Agreement; instead, it bound Netco by estoppel. (*Id.* at 8a-9a).

incorporated arbitration rules, including any rule authorizing arbitrators to determine arbitrability.

In sum, this case has nothing to do with whether an arbitrability clause that is incorporated by reference satisfies *First Options'* "clear and unmistakable evidence" standard. Instead, the real issue here is whether clear and unmistakable evidence of an agreement to arbitrate arbitrability exists when such a provision is non-existent at the time the party signed the document that binds him to arbitrate. Regardless of the existence of an arbitrability clause – be it on the face of the document or incorporated by reference – a court cannot abdicate its duty to decide the gateway issue of whether a non-signatory is bound by an agreement it did not sign.

II. Petitioners Have Not Shown A True Conflict

Even if petitioners had raised a live issue, their Petition should still be denied. Petitioners cite to only one case – from the South Dakota Supreme Court – that expressly held that incorporation of an arbitrability clause by reference is insufficient to constitute clear and unmistakable evidence of an agreement to arbitrate arbitrability. *See Flandreau Pub., Sch. Dist. #50-3 v. G.A. Johnson Constr., Inc.*, 701 N.W.2d 430 (S.D. 2005). An overwhelming majority of courts, on the other hand, have held that incorporation by reference is sufficient. *See Apollo Computer v. Berg*, 886 F.2d 469 (1st Cir. 1989); *Contec Corp. v. Remote Solution Co.*, 398 F.3d 205 (2d Cir. 2005); *FSC Sec. Corp. v. Freel*, 14 F.3d 1310 (8th Cir. 1994); *Terminix Int'l Co. v. Palmer Ranch Ltd. P'ship*, 432 F.3d 1327 (11th Cir. 2005); *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76 (Del. 2006).

A single aberration does not create the type of intolerable conflict that justifies this Court's intervention. As Justice Stevens wrote:

> [T]he existence of differing rules of law in different sections of our great country is not always an intolerable evil * * *. It would be better, of course, if federal law could be applied uniformly in all federal courts, but experience with conflicting interpretations of federal rules [of law] may help to illuminate an issue before it is finally resolved and thus may play a constructive role in the lawmaking process. The doctrine of judicial restraint teaches us that patience in the judicial resolution of conflicts may sometimes produce the most desirable result.

Stevens, J., *Some Thoughts on Judicial Restraint*, 66 Judicature 177, 183 (1982).

Patience in the present case may well reveal that the *Flandreau* decision will remain isolated, or be overturned. There is insufficient confusion in the lower courts now to justify this Court's intervention, even if the present case affected the perceived "conflict" in any way.

CONCLUSION

For these reasons, petitioners' Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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